

ICPS newsletter®

Ukraine's economy will grow at a moderate pace

The latest issue of "Quarterly Predictions" with ICPS's updated forecast for political and economic developments over the next three years has been released. According to the Centre's economists, Ukraine's economy will grow at a moderate pace. The ICPS forecast is for real GDP to grow 6.5% in 2008 and 5.5% per annum over 2009–2010

According to ICPS estimates, real GDP grew 7.2% in 2007. The role of domestic demand in the economy has grown stronger. The contribution of gross national expenditures (GNE)—the sum of consumption, investment and change in inventories—to GDP growth was 14.2 pp, almost equal to the indicator for 2005. Whereas domestic demand was mainly driven by consumption in 2005, investment played a stronger role in 2007.

Gross fixed investment grew a record-high 23% in 2007. Compared to 2003–2004, when investment also grew at a rapid pace, the factors driving growth changed in 2007. Earlier, rapid growth in gross fixed investment was largely determined by public mega projects.

Now, it is being driven by the private sector. This means that investment trends are becoming more predictable and stable.

ICPS analysts expect the coming of the BYT+NU–NS coalition to power not to lead to changes in economic policy. The priority for the Government in 2008 will be the fulfillment of social promises. The Tymoshenko Government will increase public sector salaries, pensions, and benefits to families with children. During the forecast period, no structural reforms will be implemented. Of all reforms, the most likely in 2009 are continuing pension reform, with the introduction of the accumulation pillar of the pension system, and the beginning of military reform.

The ICPS forecast is for GDP to grow 6.5% in 2008 and 5.5% per annum over 2009–2010. During the forecast period, the main driver of economic growth will continue to be consumption, but as this slows down, the relative role of investment in economic growth will become stronger. The share of investment in GDP will grow from 24% in 2006 to 32% by 2010, while the share of consumption will slip from 80% in 2006 to 76% in 2010.

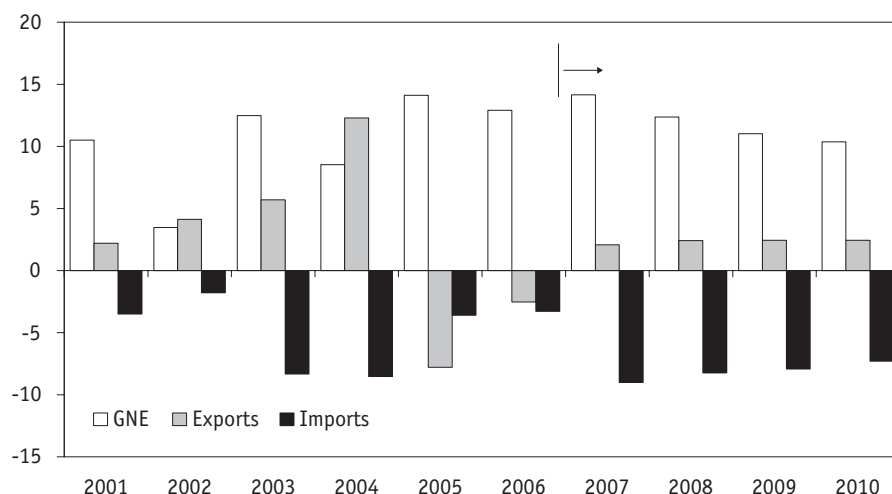
During the forecast period, imports will continue to grow faster than exports, according to ICPS analysts. The negative trade and the current account balances will continue to deteriorate, amounting to 7.8% of GDP and 7.4% of GDP in 2010.

In 2008, imported gas is going up 38%, to US \$179.50/1,000 cu m at the Ukrainian border. ICPS economists say this increase in the cost of gas will have almost no impact on industrial growth. In the main energy-intensive sectors, such as steel and mineral fertilizers, profitability will shrink, but will remain high as world prices for steel products and fertilizers continue to rise in 2008.

According to the ICPS forecast, CPI will grow 10% in 2008, 9.5% in 2009 and 9% in 2010. The main factor behind CPI growth will be the revision of regulated rates, in particular for residential services (utilities and maintenance). However, ICPS economists expect residential gas rates to grow more slowly than the price of imported gas. The Government will continue to supply gas extracted in Ukraine to residential consumers and the residential services sector at prices below those for industrial consumers. PPI growth will also slow down.

ICPS economists expect the NBU to support the hryvnia exchange rate unaltered at UAH 5.05/USD until the end

Contribution of GDP components to real growth, pp



Source: Derzhkomstat; calculations and forecast by *quarterly predictions*

Key macroeconomic indicators

Years	2006	2007	2008	2009	2010
Indicator	estimate		forecast		
GDP, mn. UAH	537.7	704.3	863.7	1,033.1	1,217.9
GDP, apc, %*	7.1	7.2	6.5	5.5	5.5
Real industrial output, apc, %	6.2	10.5	8.5	7.0	6.0
Real agricultural output, acc, %	2.5	-5.0	7.0	2.0	2.0
Gross investment, % of GDP	24.3	27.6	29.5	30.5	32.1
Real gross fixed investment, apc, %	18.7	23.0	18.0	15.0	15.0
Real consumption, apc, %	11.9	10.9	10.0	9.5	7.7
Net FDI, mn USD	5,737	8,000	8,500	9,200	9,700
Real disposable household income, apc, %	13.4	12.0	12.5	12.0	10.0
Real retail trade, apc, %	26.4	29.0	26.0	23.0	18.0
Consumer price index, apc, %	11.6	15.0	10.0	9.5	9.0
Producer price index, apc, %	14.1	20.5	12.0	10.0	8.0
Population, mn	46.9	46.6	46.2	45.9	45.6
Average monthly real wages, apc, %	18.3	12.5	11.5	11.5	10.0
Unemployment rate (ILO methodology), %	6.8	6.7	6.4	6.2	5.9
Exports of goods and services, apc, %	13.2	23.2	19.7	17.4	15.8
Imports of goods and services, apc, %	22.0	27	22.5	20.8	19.2
Current account balance, % of GDP	-1.5	-3.3	-4.5	-6.0	-7.4
Consolidated Budget balance, % of GDP	-0.7	-1.0	-1.0	-1.5	-1.5
Official exchange rate (average annual), UAH/USD	5.05	5.05	5.05	5.05	5.05

*apc = annual percentage change

Sources: Derzhkomstat (State Statistics Committee), National Bank of Ukraine, Ministry of Finance; calculations and forecast by **quarterly predictions**

- pensions will be re-calculated in 2008 but this re-calculation will not cause a significant Pension Fund deficit;
- the NBU will support the UAH/USD exchange rate unchanged throughout the forecast period.

Forecast risks

Seven factors represent potential risks to the ICPS forecast:

- a steep drop in steel prices on world markets over 2009–2010, leading to slower growth of exports and, thus, slower GDP growth, compared to forecast indicators;
- a much-higher-than-expected increase in the price for imported gas over 2009–2010, leading to slower industrial growth;
- a drop in prices for mineral fertilizers on global markets in 2008. Along with growing prices for gas, this would lead to shrinking profitability and a cut in output;
- the return of all depreciated soviet deposits during two years, spurring higher inflation;
- shrinking inflows of foreign capital into the corporate sector in 2008 due to a global financial crisis;
- a stronger hryvnia against the US dollar in 2008, as the export lobby in the new Government grows weak;
- the US dollar falling below USD 1.50/EUR in 2008. ■

*ICPS economists have been providing regular forecasts for the development of the country's economy since 1997. The ICPS forecast is updated on a quarterly basis and published in **quarterly predictions**. To subscribe to this publication, contact Andriy Starynskiy by telephone at (380-44) 484-4410 or via e-mail at marketing@icps.kiev.ua. For additional information, contact ICPS Senior Economist Ildar Gazizullin by telephone at (380-44) 484-4400 or via e-mail at igazizullin@icps.kiev.ua.*

of the forecast period. Over 2008–2009, upward pressure on the hryvnia will subside as the trade deficit rises, to be replaced by downward pressure on the hryvnia in 2010.

Rapid economic growth will continue to foster demand for Ukrainian assets. According to the ICPS forecast, FDI will keep going up, to US \$8.5bn in 2008, US \$9.2bn in 2009 and US \$9.7bn in 2010.

Forecast assumptions

The latest ICPS forecast is based on eight assumptions:

- the price of imported natural gas will be US \$179.50/1,000 cu m in 2008, US \$190–220/1,000 cu m in 2009 and US \$220–250/1,000 cu m in 2010;
- world prices for steel products will grow more slowly over 2008–2009, compared to 2007, and dip in 2010;
- prices for mineral fertilizers will grow 10–15% in 2008;
- VAT Odesa Port Plant will be sold off in 2008;
- if the BYT+NU–NS coalition survives, the Draft Tax Code developed by the Yanukovich Government will not be adopted during the forecast period. Given the weakness of this coalition, an alternative Draft Tax Code will not be adopted before 2009 and will not come into force before 2010;
- the minimum monthly wage will be raised to UAH 600 by the end of 2008 and the Single Public Sector Salary Scale will be introduced in full in Fall 2008;

icps newsletter is a weekly publication of the International Centre for Policy Studies, delivered by electronic mail. To be included in the distribution list, mail your request to: marketing@icps.kiev.ua.

icps newsletter editor: Olha Lvova (olvova@icps.kiev.ua)
Phone: (380-44) 484-4400. Fax: (380-44) 484-4402
English text editor: L.A. Wolanskyj
Articles may be reprinted with ICPS consent.

The International Centre for Policy Studies is an independent research organization whose mandate is to promote the introduction of public policy concepts and practices in Ukraine. This is achieved by increasing the know-how of key government officials for policy choices, formulation and debate, and the awareness of the public-at-large of the benefits of policy.
Address: vul. Pymonenka 13A, Kyiv, Ukraine 04050
Web-site: <http://www.icps.com.ua/eng/>